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IN THE

Supreme Court of the United States

OCTOBER TERM, 1968

No. 803

FIRST NATIONAL BANK IN ANOKA,

Petitioner,

vs.

EDWARD R. KENNEALLY, TRUSTEE IN BANKRUPTCY OF REED PLUMBING, HEATING AND AIR CONDITIONING, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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1968—Northwest Brief Printing Co., 322 S. Fourth St., Minneapolis 55415 338-5078

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The First National Bank in Anoka, a national banking association, by Thomas G. Lovett, Jr., its attorney, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit entered in this case on September 24, 1968, as amended on October 31, 1968.

OPINIONS BELOW

The findings, conclusions and order of the referee is appended (App. 11-31). The referee's certificate and return on petition for review is appended (App. 31-40). The opinion of the United States District Court for the District of Minnesota is appended (App. 41-49). The opinion of the Court of Appeals (App. 49-63) is reported at 400 F.2d 838.

JURISDICTION

The judgment of the Court of Appeals was entered on September 24, 1968. Thereafter, on October 31, 1968, the Court of Appeals denied the petition for rehearing and, by further order, amended its opinion of September 24, 1968. On November 1, 1968, the Court of Appeals entered its order denying the motion of Minnesota Bankers Association, First National Bank of Minneapolis and Northwestern National Bank of Minneapolis for leave to file brief amicus curiae in support of the petition for rehearing. The jurisdiction of this Court is invoked under 28 *U.S.C.* 1254(1).

QUESTIONS PRESENTED

1. Whether the Court of Appeals, consistent with the accepted and usual course of judicial proceedings as compassed within the concept of due process of law, may interpolate its own factual determination as a necessary predicate for reversal of the District Court which had affirmed the referee in bankruptcy, by finding:

> "Implicit in the above findings which are supported by the record is the unstated finding that the security instruments were signed by Albert Reed after Mrs. Reed had signed the note."

2. Whether the Court of Appeals:

a. Decided an important question of state law in a decision conflicting with applicable state law in that it failed to follow the state law distinction between estoppel in pais, requiring reliance, and the simple equitable doctrine, that absent fraud, one cannot successfully avoid an agreement under which he has received and retained money or property.

b. Refused to apply the well recognized state law and universal rule, that absent fraud, a corporation is bound

by the knowledge of each and all of its corporate officers gained in the usual course of its corporate business.

3. Whether the Court of Appeals erred in refusing to apply the rule established by applicable decisions of this Court, that the bankruptcy court functions essentially as a court of equity and that equitable processes govern the exercise of that court's jurisdiction.

STATUTE INVOLVED

Section 60 a (1) of the Bankruptcy Act of 1898, as amended, 11 *U.S.C.* 60 a (1), provides:

> A preference is a transfer, as defined in this title, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this title, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

STATEMENT

This is an action instituted by a trustee in bankruptcy by a petition filed in bankruptcy court for the District of Minnesota, Fourth Division, in which he alleged, in substance, that First National Bank in Anoka had been the beneficiary of a preferential transfer as defined by the provisions of Section 60(a) of the Bankruptcy Act of 1898, 11 *U.S.C.* 96(a). The opinions of the referee and the District Court disclose the following pertinent facts.

The bankrupt, a Minnesota corporation, was incorporated pursuant to Minnesota law on November 23, 1963. During the period of time between the date of incorporation and April 8, 1964, it had borrowed money from petitioner, First National Bank in Anoka. The loans had been secured by

assignments of accounts receivable. On April 8, 1964, the president of the bankrupt, Albert F. Reed, Jr., negotiated a new loan with petitioner for $16,000.00. A corporate promissory note was executed on that day by Albert F. Reed, Jr., Pres., and Marcella E. Reed, with no designation of her office. The promissory note on its face stated that the maker had deposited with the lender as collateral security for the payment of the note, the following: "Assignment of accounts receivable list dated April 4, 1964, in the sum total of $21,015.45 and factor's lien." The assignment of accounts receivable and the factor's lien were both executed by the corporation on the same day with the single signature of Albert F. Reed, Jr. Of the proceeds of the loan, it appears that $11,436.94 was applied to the existing balance owed by the bankrupt corporation to petitioner and the sum of $4,563.06 was deposited in the corporate account. The collateral agreement previously held by the bank was released. Subsequently, between April 8, 1964, and June 12, 1964, the date of bankruptcy, petitioner had received $9,095.36 in repayment on the note. The trustee had alleged in his initial petition that the petitioner had received the sum of $1,100.00 on or about May 12, 1964, as a repayment on a loan made by Albert F. Reed, Jr., from petitioner on March 13, 1964, in the amount of $4,300.00. The proceeds of the loan obtained by Reed were, at his direction, deposited in the bank account of the corporation. The trustee alleged that the repayment of $1,100.00 on the sale by Reed of a part of the collateral securing the note was preferential.

The referee found that the trustee had introduced evidence tending to establish some of the elements of a preference, but introduced no evidence tending to establish the greater percentage element and thus failed to prove that petitioner was the beneficiary of a preferential transfer as defined by Section 60(a) of the Bankruptcy Act of 1898. The referee

further determined that the equitable principles applied by the Minnesota Supreme Court were applicable—that he who seeks equity must do equity and that he who seeks equitable relief incidental to a transaction in which he received benefits must return such benefits before he can be awarded such relief—and determined that the trustee was not entitled to the relief prayed for.

The District Court in the memorandum attached to its order confirming in all respects the findings, conclusions and order of the referee, stated with respect to the validity of the security instruments:

> "This Court believes and concludes that the securities were validly executed and thus were valid and legal collateral obligations of Reed, Inc."

The Court of Appeals found that the security instruments were invalid because they did not contain the signature of the secretary of the corporation. It found that the president's authority to execute the instruments by himself was not expressly authorized because such authority was negated by the terms of the by-laws; that he did not have implied authority because he did not have express authority, and because authority to give security instruments cannot be inferred from the authority to borrow, he did not have apparent authority. It found that the act of the officer was not ratified by the corporation because there was no evidence that any corporate officer, other than the "wrongdoer," had any knowledge that the security instruments had been granted to the bank by the president of the corporation. Finally, the Court of Appeals reversed the finding of the referee and the District Court that the trustee was equitably estopped to contest the validity of the security instrument because two elements of the doctrine of equitable estoppel were missing. The case was remanded with directions to conduct an additional hearing to determine whether there was a valid as-

signment of accounts receivable from an earlier period in force, and, if valid, to determine its value. On October 8, 1968, petitioner filed with the Court of Appeals a petition for rehearing. On October 8, 1968, the Minnesota Bankers Association, the First National Bank of Minneapolis and the Northwestern National Bank of Minneapolis filed a motion with the Court of Appeals for leave to file a brief amicus curiae in support of the petition for rehearing. The Court of Appeals, by its order of October 31, 1968, denied the petition for rehearing and amended its opinion to find an "unstated finding" by the referee which it felt was implicit in his findings. On November 1, 1968, it entered its order denying the motion for leave to file brief amicus curiae.

REASONS FOR GRANTING THE WRIT

The Court of Appeals held that the security agreements, because they were not executed on behalf of the corporation in strict accord with the by-laws of the corporation, are absolutely invalid, notwithstanding the fact that the corporation did receive and use, for proper corporate purposes, the entire proceeds of the corporate promissory note for which the security instruments were given as collateral security. The Court of Appeals, while purporting to agree with the "findings" of the referee, found, by implication and directly, certain facts, as follows: That Albert Reed signed the security instruments after Mrs. Reed had signed the note; that Albert Reed was a wrongdoer; that Mrs. Reed, as a corporate officer, had no knowledge of the security instruments; and stated, "It is conceded that the bankrupt was insolvent as of April 8, 1964." The corporate promissory note recited on its face that the security instruments were given as collateral security for the note. No evidence whatever was adduced by the trustee to support the finding by the Court of Appeals that Albert Reed signed the note *after* Mrs. Reed. No evi-

dence was adduced to support a finding by the Court of Appeals that Albert Reed was a wrongdoer and it is equally clear from the promissory note, an instrument complete on its face, that Marcella Reed knew of the security instruments. No basis whatever exists in the record for the finding by the Court of Appeals that, "It is conceded that the bankrupt was insolvent as of April 8, 1964." The Court of Appeals in making its own factual determination in complete disregard of the accepted and usual course of judicial proceedings constitutes a denial of due process of law.

The Court of Appeals has here decided an important question of state law in a decision conflicting with the Minnesota law in failing to follow the distinction between estoppel in pais, often referred to as equitable estoppel, and the simple equitable doctrine that, absent fraud, one cannot successfully avoid an agreement under which he has received and retained money or property. It is well established and has long been the law of Minnesota that he who seeks equity must do equity and that he who seeks equitable relief incidental to a transaction in which he received benefits must return such benefits before he can be awarded such relief.[1] The referee determined that the bankrupt, having received the benefits, used the money, and never restored the same, is not entitled to the relief it sought. The District Court, while it used the words "equitably estopped," intended merely to affirm the referee's finding. The *doctrine* of "equitable estoppel" or "estoppel in pais," requiring reliance, was not applied. The reference by the Court of Appeals to that doctrine is not relevant.

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[1] *Bloomingdale v. Cushman*, 134 Minn. 445, 59 N.W. 1078; *Marin v. Calmenson*, 158 Minn. 282, 197 N.W. 262; *Thompson v. North Star Muskrat Farm, Inc.*, 183 Minn. 314, 236 N.W. 461.

The Court of Appeals in refusing to apply the well recognized state law and universal rule that, absent fraud, a corporation is bound by the knowledge of each and all of its corporate officers gained in the usual course of its corporate business has made a decision in conflict with applicable state law. The law in Minnesota is well established in acceptance of the foregoing principle. The Court of Appeals in finding, without the benefit of any evidence or even any allegation in pleadings in the record, that Albert Reed was a wrongdoer, applied the law of the state applicable to the exception applied only in cases of fraud or wrongdoing. The officer of the corporation acting here on behalf of the corporation was its president and principal officer.

This decision represents a change in what has long been understood to be the law in the State of Minnesota and can reasonably be expected to jeopardize the collateral security for millions of dollars in outstanding loans which have been made by the various commercial banks in the State of Minnesota. The impact of this decision upon the lending and other financial institutions in the State of Minnesota and the possible adverse effect upon millions of dollars of secured transactions was the basis of the motion by the Minnesota Bankers Association, the First National Bank of Minneapolis and the Northwestern National Bank of Minneapolis for leave to file a brief amicus curiae.

The rule of this case appears to require the lender to trust not only in the integrity of the corporate officer with whom it is dealing but also in his abilities as a corporate lawyer. Before this decision, a lender was secure if it had been able to assure itself, by one means or another, that a corporate officer was in fact borrowing money for a legitimate corporate purpose with the consent of his concerned fellow corporate officers. The decision here would require a strict review of the actual corporate by-laws by a person qualified

to make such a review before it could accept without peril a security agreement from a business corporation.

The referee determined that, in equity, the trustee was not entitled to the relief prayed for by his petition. The Court of Appeals refused to consider the grounds upon which the referee reached his conclusion and dealt only with the doctrine of equitable estoppel.

This Court has, on numerous occasions in recent years, commented on the equity jurisdiction of courts of bankruptcy. It is well established that bankruptcy courts are essentially courts of equity, *Katchen v. Landy,* 382 U.S. 323, 327; there is an overriding consideration that equitable principles govern the exercise of bankrupty jurisdiction, *Bank of Marin v. England,* 385 U.S. 99, 103; and that equitable powers have been invoked to the end that substance will not give way to form and that technical considerations will not prevent substantial justice from being done. *Pepper v. Litton,* 308 U.S. 295, 304.

This decision, if it is allowed to stand, will be especially unfortunate in that it comes at a time when the business community and state legislatures are engaged in an effort to rid the laws of commerce of rules and regulations which have placed compliance with legal formalities ahead of practicality and fair play. Chapter 9 of the *Uniform Commercial Code,* recently adopted by Minnesota, has as one of its stated purposes the abolition of formal legal requirements relating to the effective granting of security instruments. The abolition of the requirement of formal acknowledgments and of the use of specified formal language in these instruments are but two examples of the continuing trend to rid the business community of needless limitations upon its activities and of useless expense entailed in efforts to comply with legal formalities and the consequences which have traditionally ensued when these attempts failed.

For the foregoing reasons, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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APPENDIX

United States District Court
District of Minnesota
Fourth Division

In the Matter of Reed Plumbing, Heating and Air Conditioning, Inc., Bankrupt.

FINDINGS, CONCLUSIONS AND ORDER

(Filed June 29, 1967)

(Entered at Minneapolis, Minnesota, June 29, 1967.)

(The First National Bank of Anoka, in Anoka, Minnesota, will be referred to herein as "the bank.")

I.

This controversy arises upon the petition of the trustee of above bankrupt estate containing various counts.

In his petition, the trustee alleges in substance—

1. With the consent of the bank and by authority of the bankruptcy court the trustee sold, free and clear,

(a) certain merchandise and equipment belonging to above bankrupt estate for the sum of $8,668.28 and

(b) two certain Chevrolet trucks for the sums of $35.00 and $250.00, respectively.

2. Upon the proceeds of the sale of the two Chevrolet trucks, the bank claims a lien based on a chattel mortgage which is invalid as against the trustee for the reasons (a) that the mortgage was not executed as a corporate instrument but, on the contrary, was executed by Albert F. Reed, Jr., as an individual and (b) that the mortgage was belatedly filed for public record;

3. The bank was the beneficiary of a prebankruptcy transfer by the bankrupt to the bank of accounts receivable owned by the bankrupt, totaling $21,015.45 in their face amounts, which constituted a preference within Section 60 (11 U. S. Code 96); and

4. Subsequent to the assignment of the receivables mentioned in foregoing (3) and prior to the date of bankruptcy herein, the bank obtained a factor's lien agreement covering the bankrupt's inventory, which constituted a preferential transfer within said Section 60 of the act and, further, the factor's lien agreement is invalid as against the trustee for the reasons (a) that it was not executed as a corporate instrument and (b) was without a valid and present consideration.

II.

In its answer to the trustee's petition, the bank alleges in substance—

1. The bank holds a valid chattel mortgage covering the two Chevrolet trucks mentioned in foregoing Paragraph I (1) (a), the balance due the bank on the mortgage being the sum of $3,200.00, the mortgage having been executed by Albert F. Reed, Jr., who had and represented that he had the title to the trucks, the title registration cards having been delivered to the bank by Reed whose representations were relied upon by the bank, the chattel mortgage having been filed for public record within a reasonable time and without prejudice to the rights of the bankrupt's other creditors.

2. The assignment of the receivables and the factor's lien agreement covering inventory were executed by the bankrupt corporation as a part of a loan transaction to secure a new loan made to the bankrupt in the sum of $16,000.00 which the bankrupt corporation received, the note evidencing the loan having been signed by (a) Albert F. Reed, Jr., the

bankrupt's president and general manager and the only corporate officer of the bankrupt actively engaged in the conduct of the bankrupt's business affairs and (b) Marcella E. Reed (secretary of the bankrupt corporation).

3. At the time the loan transaction aforesaid occurred, the bank had no knowledge of or reasonable cause to believe the bankrupt was insolvent and reliance was placed upon (a) the direct representations of Reed as the bankrupt's president that the bankrupt was solvent and (b) current financial statements of the bankrupt which did not in any way disclose the corporation's insolvency; that by accepting delivery of the security instruments the bank did not obtain and had no intention of obtaining a greater percentage of its debt than any other creditor and that the amount of the loan was used to pay the claims of the bankrupt's general creditors.

III.

Above titled bankruptcy proceeding was initiated by the filing of the bankrupt's voluntary bankruptcy petition on June 12, 1964.

IV.

At all the times material herein Edward R. Kenneally of Minneapolis, Minnesota, has been and still is the duly appointed, qualified and acting trustee of the bankrupt's estate.

Hereinafter, Reed Plumbing, Heating and Air Conditioning, Inc. will be referred to as "the bankrupt" or "the bankrupt corporation"; and Jarnig Plumbing & Heating Company will be referred to as "Jarnig".

V.

The bankrupt was incorporated November 21, 1963, to generally engage in the business of plumbing, heating and air conditioning under and pursuant to the provisions of the Minnesota Business Corporation Act. The articles of in-

corporation provide that the business of the corporation shall be managed by the board of directors. Trustee's Exhibit 1.

The corporate by-laws provide (Article II) that all notes, deeds, mortgages, checks, stock certificates, leases, and transfer of business equipment shall require the signatures of the president and the secretary of the corporation. Trustee's Exhibit 2.

Under the Minnesota Business Corporation Act (1933 c 100 s 23 to be found Minn. Stats. 1965, Sec. 301.24) it is provided that the shareholders may make by-laws, not inconsistent with law or the articles of incorporation, for the government of the corporation, the conduct of its affairs and the management of its properties and business.

Under said Act (1933 c 300 s 29 to be found Minn. Stats. 1965, Sec. 301.30, Subd. 2) all of the corporate officers shall, respectively, have such authority and perform such duties in the management of the business of the corporation as may be prescribed by the by-laws, or, in the absence of controlling provisions in the by-laws, as may be determined by the board of directors.

VI.

At all the times material herein, the officers, directors and stockholders of the bankrupt were:

Albert F. Reed, Jr., president and director holding thirty per cent of the corporate stock;

Rosina Popp, vice president and director holding fifty per cent of the corporate stock;

Marcella Reed, secretary and director holding ten per cent of the corporate stock, and

Marie Reed, treasurer and director holding ten per cent of the corporate stock.

VII.

On November 26, 1963, the board of directors of the bankrupt adopted a resolution (Trustee's Exhibit 13) (Respond-

ent Bank's Exhibit B-3) designating the bank as a depositary of the bankrupt and directing that the withdrawal of funds from the corporate bank account be upon the signatures of Albert F. Reed, Jr., as president, and Marcella Reed, as secretary, and authorizing both of them to jointly borrow money in behalf of the bankrupt corporation from the bank in the name of the corporation and to execute notes or agreements in the forms required by the bank for repayment of the borrowed funds, and further specifying that "said officers hereby are authorized to pledge or mortgage * * * bills receivable * * * or other property real or personal of the bankrupt corporation for the purpose of securing payment of any moneys so borrowed * * *."

A copy of the foregoing resolution was filed with the bank and at all the times material herein was in the bank's possession and known to and by the representatives of the bank who engaged in the loan transactions hereinafter mentioned (testimony of the bank's vice president and cashier—p. 112 transcript).

Further, Trustee's Exhibit 12 is a record of the bank relating to the opening of the business account of the bankrupt corporation in the bank and to the foregoing resolution of the board of directors of the bankrupt corporation, adopted Nov. 26, 1963. Trustee's Exhibit 12 shows that the several signatures of Albert F. Reed, Jr., as president of the bankrupt corporation and of Marcella E. Reed, as secretary of said corporation, were required for the transaction of business with the bank in connection with the corporate bank account. Transcript—pages 15-17.

VIII.

On March 10, 1964 (subsequent to Nov. 21, 1963, the date of the bankrupt's incorporation) Jarnig agreed to sell to the bankrupt all of Jarnig's inventory of plumbing and heating materials and supplies in existence on November 25,

1963, as well as all of Jarnig's tools and equipment, in consideration of the sum of $16,300.00, $7,650.00 to be paid in cash upon the execution of the agreement, $4,325.00 to be paid in cash on or before March 31, 1964, the balance to be paid for in labor and materials furnished Jarnig by bankrupt (Trustee's Exhibit 3).

In the main, the bankrupt actually assumed Jarnig's business operation on November 25, 1963. The sale agreement was not signed until March 10, 1964 because the bankrupt and Jarnig "were negotiating the inventory" and Jarnig was "stalling". (Reed's testimony pages 63-64, transcript.)

The last four lines of Section 1 of the sales agreement (Trustee's Exhibit 3) make it clear that the term "equipment" employed in the sale agreement included Jarnig's motor vehicles inasmuch as (1) the bankrupt agreed to assume the conditional sale contract describing a stake truck and (2) it was agreed that Jarnig should "retain a station wagon now on lease".

Pursuant to the sale agreement (Trustee's Exhibit 3) the Trustee's Exhibits 4 through 8 tend to establish that Jarnig transferred various trucks to the bankrupt corporation. In this connection see Paragraph X hereof.

IX.

On March 13, 1964, to secure repayment of the sum of $4,300.00, the bank obtained a note (Trustee's Exhibit 11) and a chattel mortgage on five Chevrolet trucks (Trustee's Exhibit 10). Both the note and mortgage were signed by "Albert F. Reed, Jr." individually. The name of the bankrupt corporation does not appear on either exhibit.

Trustee's Exhibits 10 and 11 (the note and chattel mortgage) were offered by the trustee's counsel "to show that these documents are executed by Albert F. Reed as an individual and that the purported security is not a corporate act." (Transcript—p. 13.)

X.

During the course of the hearing held in this matter, a considerable amount of time was devoted to the disposition made of the five trucks described in the bank's chattel mortgage (Trustee's Exhibit 10). The interrogation centered around the subject matter of Trustee's Exhibits 4, 5, 6, 7 and 8. Obviously, the interrogation was aimed at establishment of the fact that all five of the mortgaged trucks actually belonged to the bankrupt corporation. However, as the pleadings in this dispute show, we are concerned here with only two of the trucks, to-wit:

1953 Chevrolet one-ton panel truck, Serial No. L 53J-022134, referred to below as "Truck A" and

1958 Chevrolet half ton pick-up truck, Serial No. 3B58J-111306, referred to below as "Truck B".

Trustee's Exhibit 4 (5 pcs) shows that Truck A was registered in Jarnig's name; that it was transferred by Jarnig to the bankrupt corporation May 5, 1964; that on January 11, 1965 it was transferred to Albert F. Reed, Jr. by the trustee of the bankrupt's estate in consideration of the sum of $35.00 and that on February 16, 1965 it was transferred by Albert F. Reed, Jr. to William P. Nelson.

Trustee's Exhibit 5 (6 pcs) shows that Truck B was registered in Jarnig's name; that it was transferred by Jarnig to the bankrupt corporation May 5, 1964 and that on January 11, 1965 it was transferred to Theodore Bixler by the trustee of the bankrupt's estate in consideration of the sum of $250.00.

The official records relating to this bankruptcy proceeding, of which notice is taken, show:

(1) A stipulation in writing entered into as of Aug. 19, 1964 between respective counsel for the trustee and for the bank to the following effect:

That the property of the bankrupt as scheduled and as inventoried may be sold free and clear of any claimed liens or assignments of the First National Bank of Anoka, Minnesota. This stipulation is conditioned, however, as follows:

That the property be sold for an amount over and above the amount of the bank's claimed lien, and that the proceeds of the sale stand in the place of the property subject to the claimed lien of the bank:

NOTE: On the hearing no issue was made respecting the price at which the property was sold; consequently, the question whether the property was sold for as much or more than the amount of the bank's claimed lien is not here presented.

(2) A petition executed Jan. 4, 1965 by the trustee for authority to sell Truck A to Albert F. Reed, Jr. for the sum of $35.00 and an order entered Jan. 11, 1965 confirming such sale, and

(3) A petition executed Jan. 4, 1965 by the trustee for authority to sell Truck B to Theodore G. Bixler for the sum of $250.00 and an order entered Jan. 11, 1965 confirming such sale.

XI.

The bank has consistently contended that Albert F. Reed, Jr. individually gave the bank the note and mortgage (Trustee's Exhibits 10 and 11). This contention finds adequate support in the following premises:

(a) As stated above, neither exhibit bears the name of the bankrupt corporation. Both the note and mortgage were signed "Albert F. Reed, Jr."

(b) In this bankruptcy proceeding, the bank seasonably filed proof of claim No. 16 in the sum of $3,303.21 executed and verified July 31, 1964 by the bank's president, D. H. Gregerson. In this proof of claim, it is alleged (1) that the consideration of said debt is "monies loaned to said bankrupt for the use and benefit of Reed Plumbing, Heating and

Air Conditioning, Inc." and (2) that the bank's security consisted of a "chattel mortgage on five Chevrolet trucks."

> (The referee is satisfied that the word "bankrupt" was inadvertently employed out of context and that the bank intended to indicate that the loan was made to Reed for the use and benefit of the bankrupt corporation.)

In relation to the chattel mortgage transaction of March 10, 1964, involving the trucks, the witness Reed testified that at that time there was an overdraft of approximately $4,000.00 in the bankrupt corporation's account in the bank (p. 53, transcript) that in discussing the loan application with Mr. Gregerson (the bank's president), he (Reed) informed Mr. Gregerson that Jarnig held security for the remainder of the balance due on the sales agreement (mentioned in Paragraph VIII of these findings and conclusions) but that there was some prospect at least that "a third party" might contribute some additional capital to the bankrupt corporation (p. 54, transcript); and that a prior encumbrance existed on one of the trucks (p. 55, transcript). In support of the witness Reed's testimony, see the bank's comment sheet, dated March 26, 1964 (Trustee's Exhibit 18) showing that Reed had "indicated that he has sources of additional capital to be invested in the company." The witness Reed was asked (p. 55, transcript) how it happened that he executed the bank's note and mortgage as an individual and he answered, in substance, that Mr. Gregerson explained to him that the note "was to serve as my personal guarantee."

At the bottom of page 123 of the transcript, the witness Gregerson, the bank's president, was asked:

> Q. How did it come about that this loan was made to Mr. Reed personally?
>
> A. *To my recollection* (italics supplied), at this time the full transfers of assets had not been made from Mr.

> Jarnig. And at this particular time, the assets, such as the motor vehicles mentioned, had not been transferred to the (bankrupt) corporation. *And if I recall correctly* (italics supplied), Mr. Reed made the statement that he did not know whether or not these particular assets would be put into the (bankrupt) corporation.

The referee thinks there may well have been these additional considerations: The then young bankrupt corporation had been organized approximately three months prior to the date of the note and mortgage (Trustee's Exhibits 10 and 11). Reed's statement (in effect) that additional capital was being solicited in behalf of the bankrupt corporation warranted the belief on the part of the bank's president that the bankrupt corporation was undercapitalized and that on account of prior encumbrances on the trucks, the trucks would afford questionable security for the loan. In these circumstances, coupled with Mr. Gregerson's testimony mentioned above (appearing at the bottom of page 123 of the transcript), the referee thinks it is consistent to believe that Mr. Gregerson, as the bank's president, elected to bind Reed individually. As stated by Reed (transcript, p. 57), "the personal note was to be, if I remember correctly, a personal guaranty, such as was done in the case of corporations where they want the individual to be tied down personally."

Further, with reference to Trustee's Exhibit 10, the witness Gregerson, the bank's president, after testifying (transcript, p. 123) that the loan on the trucks "was made for the benefit" of the bankrupt corporation, further testified:

> Q. Was the loan made to the corporation?
> A. No.
> Q. To whom was the loan made?
> A. To Albert F. Reed, Jr.
> Q. Were you as the officer in charge of the loan directed to do anything particularly with the proceeds of the loan?
> A. Yes.

Q. What were you directed to do?

A. To credit it, the proceeds of the loan, to Reed Plumbing, Heating and Air Conditioning Company.

Q. Its account with the bank?

A. That is correct.

Obviously, since the witnesses Reed and Gregerson were the parties who discussed the loan application, the foregoing direction or instruction concerning the deposit of the proceeds of the loan to the credit of the bankrupt corporation in its bank account, were given to the bank by Reed personally.

XII.

Referring now to proposition 2 (set forth in Paragraph I(2) supra) to the effect that the bank claims a lien upon the proceeds of the sale of the two Chevrolet trucks, based on a chattel mortgage which is invalid as against the trustee for the reasons (a) that the mortgage was not executed as a corporate instrument but, on the contrary, was executed by Albert F. Reed, Jr. as an individual, the referee finds the ultimate facts and conclusions to be:

The bank made the loan, evidenced by the note and chattel mortgage (Trustee's Exhibits 10 and 11) to Albert F. Reed, Jr. personally and individually. The bank did not make the loan to the bankrupt corporation.

Albert F. Reed, Jr., after obtaining the loan from the bank, turned over the proceeds of the loan to the bankrupt corporation for its use and benefit. The bank did not turn over the loan proceeds to the bankrupt corporation, but on the contrary, placed such proceeds under Reed's control and followed Reed's instruction to credit the proceeds to the account of the bankrupt corporation in the bank.

The bank must look to Albert F. Reed, Jr. personally and to his individual estate for repayment of the moneys lent. Consequently, the bank is not entitled to hold the estate of the bankrupt corporation liable for repayment of such

moneys and is not entitled to a lien on the property in the estate of the bankrupt corporation to secure repayment.

XIII.

Assignment of Accounts Receivable

(1) On April 8, 1964, the bank obtained an assignment of accounts receivable (Trustee's Exhibit 15—also Respondent's Exhibit B-1) belonging to the bankrupt corporation in the total sum of $21,015.45, which granted authority to the bank to collect and receive all moneys paid on the assigned accounts and provided that the assignment should remain in effect until all indebtedness of the bankrupt corporation to the bank was paid or the assignment was released by the bank.

This assignment was executed in the following manner:

Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr.

(2) Previously, on Feb. 24, 1964, the bank had obtained an assignment of receivables (Trustee's Exhibit 14) belonging to the bankrupt corporation in the total sum of $12,-164.00, which in its provisions was identical with the assignment of April 8, 1964 and was executed in the same manner.

(3) And there were other assignments of receivables to the bank as disclosed by the bank's comment sheet (Trustee's Exhibit 18).

XIV.

On or about April 8, 1964, the bankrupt corporation required additional financing to meet a payroll and to continue in business, Transcript, p. 23, Reed, the bankrupt's president, went to the bank for the purpose of obtaining it. An additional loan was granted in the sum of $4,563.06. This sum was deposited to the credit of the bankrupt corporation in its business account in the bank. Trustee's Exhibit 16 (bank

statement—entry April 8, 1964 in column captioned "Deposits"—also see transcript, pp. 19-22).

In connection with this transaction the bank obtained a new note (Respondent's Exhibit B) dated April 8, 1964 in the sum of $16,000.00 specifying as security: "assignment of accounts receivable list dated April 4, 1964, in the sum total of $21,015.45 and Factor's Lien." This note was signed in the following manner:

Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr., Pres.
Marcella E. Reed

The amount of the new note ($16,000.00) represented the balance due the bank on antecedent indebtedness plus the contemporaneous $4,563.06 advanced by the bank on April 8, 1964. Transcript, p. 23.

> The note (Respondent's Exhibit B) was received in evidence subject to the objections of the trustee's counsel that it contains no identification that it was signed in the corporate capacity and is not binding on the trustee and is without foundation laid (transcript, p. 87) and that nowhere in Exhibit B is there any identification whatsoever of the capacity in which Marcella Reed signed the note. The objections hereby are overruled. The referee thinks the exhibit is admissible as part and parcel of the additional financing transaction that occurred on April 8, 1964.

XV.

Factor's Lien

In the circumstances reflected in the foregoing paragraph hereof and because the bank felt insecure in lending any further money to the bankrupt corporation on receivables, the bank demanded a factor's lien on inventory. Transcript, pp. 24-25.

In the course of the discussion of the lien agreement, Mr. Gregerson (the bank's president) assured Mr. Reed (the

bankrupt's president) that the factor's lien would be of a temporary nature pending improvement in the financial condition of the bankrupt corporation (transcript, pp. 21, 23 and 26).

So on April 8, 1964, the bank obtained a factor's lien agreement (Trustee's Exhibit 19 — Respondent's Exhibit B-2) upon plumbing, heating and air conditioning supplies and other miscellaneous merchandise of like character. This agreement was signed in the following manner:

Reed Plumbing, Heating and Air Conditioning, Inc.
Albert F. Reed, Jr., Pres.

The referee has searched the record to ascertain why the note (Respondent's Exhibit B) was signed in one fashion and why the factor's lien agreement (Trustee's Exhibit 19 —Respondent's Exhibit B-2) was signed in a different manner. In the absence of satisfactory explanation, the referee thinks it is reasonable to infer that both Albert and Marcella Reed were available at the time the note was signed; that Marcella Reed was not available at the time the factor's lien agreement was signed; that the note and factor's lien agreement were not signed contemporaneously but were signed on separate and different occasions, and that Marcella Reed may have refused to sign the factor's lien agreement because of its crippling effect on the business operation of the bankrupt corporation. In this latter respect, see Transcript page 21 where Mr. Reed testified he told the bank's president that "this (the factor's lien) would tie my hands and I would be unable to move as far as getting money into the corporation."

XVa.

In this bankruptcy proceeding, the bank seasonably filed its proof of claim No. 17 in the sum of $6,904.64. In this proof of claim the bank alleges (1) that the consideration of said debt is "monies loaned to said corporation" and (2)

that the bank's security consists of a "factor's lien on plumbing supplies, heating equipment and merchandise and assignment of accounts receivable."

XVI.

With respect to the $16,000.00 note (Paragraph XIV hereof) and the factor's lien agreement (Paragraph XV hereof), both dated April 8, 1964, the record made in this case establishes the following statistical result:

> The note (signed by Albert F. Reed as president and by Marcella Reed, absent the word "Secretary") is for $16,000.00 composed of: New money advanced by the bank: $4,563.06; antecedent indebtedness: $11,436.94; total $16,000.00.
>
> Without taking into account the trustee's claim of preference, the referee thinks that the note constituted a valid corporate obligation inasmuch as in all the circumstances, the fact that Marcella Reed executed the note in her official capacity as secretary of the bankrupt corporation can reasonably be inferred.

Bearing in mind that in connection with the April 8, 1964 transactions, the total corporate indebtedness to the bank was merged in the $16,000.00 note, the further statistical result appears:

> Total corporate indebtedness to the bank as of April 8, 1964: $16,000.00.
>
> Balance due as of the date of bankruptcy—shown in bank's claim No. 17: $6,904.64.
>
> Repayment made to the bank between April 8, 1964 and the date of bankruptcy: $9,095.36.

Whether the $9,095.36 repayment figure can be deemed to embrace the $4,563.06 in new money advanced April 8, 1964 is deemed immaterial in view of the facts and conclusions set forth in the following paragraphs hereof.

XVII.

Disregarding for the moment the trustee's preference claim, the $16,000.00 note constituted a valid corporate obli-

gation, having been signed by both Albert F. and Marcella Reed (Paragraphs XIV and XVI hereof).

The assignment of the receivables to the bank (Paragraph XIII hereof) and the factor's lien agreement (Paragraph XV hereof) did not constitute valid corporate transfers to the bank of property of the bankrupt corporation, both instruments having been executed by Albert F. Reed alone.

In the opinion in Bloomingdale v. Cushman, 134 Minn. 445, 159 N.W. 1078, it is said:

> "In the present case it cannot be said that the company intended its president to possess the power to execute promissory notes, for it adopted a by-law requiring such notes to be executed by both its president and secretary and such by-law could be changed only by its stockholders, G.S. 1913, Section 6154. It is true that actual authority, whether it be express or implied, may be inferred from facts and circumstances and the acts and conduct of the parties where the nature and extent of the power given to the agent is not specifically defined. Best v. Krey, 83 Minn. 32, 85 N.W. 822. But where the principal has expressly required the concurrence of two agents to exercise a specific power, neither has the implied authority to exercise such power without the concurrence of the other. The principal intended that neither should exercise it alone."

There is no evidence in the record made in the controversy now at bar that justifies the conclusion (1) that the president of the bankrupt corporation had any authority to execute alone and by himself the instruments here under the trustees' attack or (2) that plenary authority to execute such instruments existed in the president of the bankrupt corporation alone, based by implication upon the fact that the president had been accustomed to exercise such authority with the consent and acquiescence of the other directors and stockholders of the bankrupt corporation or (3) that the shareholders and/or board of directors of the bankrupt

corporation knew or had reasonable cause to believe that Albert F. Reed, Jr., as president of the bankrupt corporation, had undertaken to obligate the bankrupt corporation to the First National Bank of Anoka by solely executing and delivering such instruments to said bank without the joint signatures thereon of himself and the secretary of the bankrupt corporation.

XVIII.

In the instant dispute, the trustee is acting pursuant to two separate and distinct statutory propositions:

> Proposition 1: The first sentence of Sec. 70c of the Act (11 U.S. Code 110c) which gives the trustee the benefit of all defenses available to the bankrupt as against third persons.
>
> (NOTE: The second sentence of Sec. 70c, giving the trustee all the rights of an ideal judicial lien creditor is without application here.)
>
> Proposition 2. Section 60 of the Bankruptcy Act which deals with preferential transfers.

With reference to proposition (1): In instances where the bankrupt might be estopped to deny the validity of certain acts, the estoppel may be imputed to the bankruptcy trustee when such trustee undertakes to set aside the results of the bankrupt's favoritism of certain creditors. Vol. 4 Collier on Bankruptcy (14) Sec. 70.45 and footnote references.

In the case now at bar, the trustee is exercising the right of the bankrupt corporation to defend itself in respect of an unauthorized act of an officer in assuming to bind the bankrupt corporation by an assignment of receivables belonging to it and by the factor's lien agreement encumbering property belonging to it, both instruments bearing date April 8, 1964. Under proposition (1), the bank is entitled to such relief as may be afforded by the record made in the instant dispute.

It is settled that in a case where the facts and circumstances happen to be as they are here, the bankruptcy court functions essentially as a court of equity and that equitable processes govern the exercise of that court's jurisdiction. In the opinion in Redmond v. United Funds Management Corp., 8 Cir., 144 F.2d 155, reference is made to "a court of conscience" which assures justice to all parties since "the malleable processes of courts of bankruptcy give assurance of a remedy that can be moulded and adapted to the needs of the occasion." Also see U. S. v. Duggan, 8 Cir., 210 F.2d 926; In re Black Ranches, 8 Cir., 362 F.2d 8; Katchen v. Landy, 382 U.S. 323; Bank of Marin v. Englund, 87 S.Ct. 274.

Although the decisions of the Minnesota Supreme Court (cited infra) rendered in disputes involving execution of instruments without authority may not be based on a state of facts identical with those in the instant dispute, nevertheless, the equitable principles applied by that court in arriving at the decisions are applicable here—that he who seeks equity must do equity and that he who seeks equitable relief incidental to a transaction in which he received benefits must return such benefits before he can be awarded such relief. See Bloomingdale v. Cushman, 134 Minn. 445, 59 N.W. 1078; Marin v. Calmenson, 158 Minn. 282, 197 N.W. 262; Thompson v. North Star Muskrat Farm, Inc., 183 Minn. 314, 236 N.W. 461.

Without reference to the trustee's preference claim:

As pointed out in Paragraph XVI hereof, on April 8, 1964, the total indebtedness of the bankrupt corporation to the bank amounted to $16,000.00. The bankrupt received the benefit of these funds. Prior to the date of bankruptcy, $9,095.36 of such total indebtedness had been repaid, leaving an unpaid balance of $6,904.64 due the bank. This unpaid balance exceeds the $4,563.06 in new money advanced by the bank and received by the bankrupt corporation on

April 8, 1964 when the assignment of receivables and the factor's lien agreement were executed by Reed alone; and on the record made in this dispute it cannot very well be held that the bankrupt corporation has returned all the benefits it received from transactions with the bank.

Accordingly, in all the premises aforesaid, it is concluded that, in equity, the trustee is not entitled to the relief prayed for on the basis of the unauthorized assignment of receivables and factor's lien agreement executed by Reed alone. And the referee thinks that any other conclusion would amount to "penalizing" the bank. Penalties are, of course, abhorrent in equity. See the opinion in Northtown Theatre Corp. v. Mickelson, 8 Cir., 226 F.2d 212 (a penalty case) holding that bankruptcy courts in administering estates are governed by equitable principles, and, while legal rights are preserved, legal remedies are lost and equitable remedies are substituted.

XIX.

Referring now to Section 60 of the Bankruptcy Act (11 U.S. Code 96):

At the hearing trustee introduced evidence tending to establish the transfer within four months of the date of bankruptcy, the antecedent indebtedness, the debtor's insolvency and reasonable cause on the part of the bank to believe the debtor was insolvent or to put the bank on inquiry in that regard. However, the trustee introduced no evidence tending to establish the statutory "greater percentage" element and tending to show that the effect of the transfer will be to enable the beneficiary thereof to obtain a greater percentage of his debt than some other creditor of the same class.

Ordinarily, in a preferential transfer case of this sort, in which the claim filing period has expired, the trustee of the bankrupt's estate is required to appear as a witness to show

the amount of money realized from the liquidation of assets of the estate during the course of its administration by the trustee,

the fair value of the assets, if any, that have not been liquidated,

the amount of administrative expenses actually paid and the amount of unpaid administrative expenses according to the trustee's best estimate,

the amount paid on secured claims, if any, in instances where the security has been liquidated by the trustee and the proceeds of the liquidation came into the trustee's hands,

the amount of wage, tax and other priority claims proved and filed against the estate, and

the amount of the unsecured claims proved and filed against the estate,

thus establishing the amount that is available for equal distribution on the unsecured claims.

When the amount available for distribution on unsecured claims has been ascertained with reasonable certainty, the amount of the dividend that can be paid on unsecured claims can be calculated and when so calculated, the benefit conferred upon unsecured claimants can be compared with the benefit conferred upon the beneficiary of the preferential transfer, thus establishing who would receive the greater benefit percentage-wise, the unsecured claimants or the beneficiary of the preferential transfer.

In the foregoing connection, the opinion in Barry v. Crancer, et al., 8 Cir., 192 F.2d 941, is directly in point.

Accordingly, it is found or concluded, as the case may be, that the trustee has failed to prove that the bank was the beneficiary of a preferential transfer.

In all the foregoing premises, it is concluded (1) that the bank's claim No. 16 (Paragraph XI hereof) to the proceeds of the Chevrolet trucks should be stricken from the official

claim register maintained in this bankruptcy proceeding and (2) that the bank's claim No. 17 (Paragraph XVa hereof) should stand as filed.

REFEREE'S CERTIFICATE
(Filed July 27, 1967)

The undersigned referee in bankruptcy hereby certifies:

Transmitted herewith are

The trustee's petition initiating this controversy between the trustee and the First National Bank of Anoka, Minnesota;

The bank's answer to said petition;

The transcript (two parts) covering the hearing held in the controversy thus arising;

All exhibits introduced upon the hearing;

The briefs of the respective parties in interest;

The referee's findings, conclusions and order entered pursuant to the hearing, and

The trustee's petition to review the findings, conclusions and order aforesaid.

(The $10.00 fee for filing the petition for review has been paid.)

In this controversy, the trustee is represented by attorneys Culhane & Culhane of Minneapolis, Minnesota, and the First National Bank of Anoka is represented by attorney Thomas G. Lovett, Jr., of Minneapolis, Minnesota.

Statement of Questions Presented

On this review, the assignments of error appear to be set forth in a manner that might be described as "referential," to the extent that the referee has encountered some difficulty in formulating the "statement of the questions presented"

required by Section 39a(8) of the Bankruptcy Act (11 U.S. C.A. 66a(8)) and in succinctly certifying the questions that may be for determination by the reviewing judge. In this connection the referee seeks the indulgence of the judge and expresses the sincere hope that if the referee's "statement of the questions presented" is not in strict conformity with what the petitioning trustee intends by way of his assignments or of any of them, error on the part of the referee in reducing the assignments to elemental substance will not be deemed purposeful. Further, the referee's comments following his statement of each question presented for review are designed and intended solely for the purpose of being helpful to the reviewing judge.

Involved here is a controversy between the trustee of the bankrupt estate of Reed Plumbing, Heating & Air Conditioning, Inc., a Minnesota corporation, and the First National Bank of Anoka (Minnesota). Accordingly, the parties in interest will be referred to as "the trustee," the "bankrupt" and "the bank."

I.

The first assignment appears in Paragraph 2 of the petition for review, alleging error on the part of the referee in stating in Paragraph I(3) of his findings and conclusions that in the trustee's petition initiating this controversy, it is alleged—

> "3. The bank was the beneficiary of a prebankruptcy transfer by the bankrupt to the bank of accounts receivable owned by the bankrupt, totalling $21,015.45 in their face amounts which constituted a preference within Section 60 (11 U.S. Code 96)."

Accordingly, the first issue presented on review is:

Whether in Paragraph I of his findings and conclusions the referee erred in undertaking to reduce to essential substance the allegations contained in the trustee's petition

when Paragraph 3(b) of said petition seems to demonstrate that the trustee pleaded the elements of a voidable preferential transfer, and, in conclusion, stated that the assignment of the receivables by the bankrupt to the bank "would amount to a voidable preference."

II.

Referring to Paragraphs 3, 4, 5, 6 and 7 of the trustee's petition for review: These assignments appear to be correlative. They refer to the Bank's Exhibit B. The petitioning trustee seems to contend that this exhibit was erroneously received in evidence over the trustee's objections grounded on

Lack of foundation,
Violation of the parole evidence rule,
and
The exhibit being outside the issues made by the pleadings

and that therefore the trustee's motion to strike this exhibit should have been granted.

To properly understand these several assignments, it is necessary to refer to the transcript of the proceedings had and to the exhibits.

The Bank's Exhibit B is a $16,000 note dated April 8, 1964, payable to the bank, signed

Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr., Pres.
Marcella Reed

the designation of Marcella Reed as secretary of the bankrupt corporation having been omitted.

The note (Bank's Exhibit B) recites collateral security for payment of the note as

"Assignment of receivable list dated April 4, 1964 in the sum total of $21,015.45 and factor's lien."

The Bank's Exhibit B-1 (adopted by the trustee as Trustee's Exhibit 15) is the assignment in writing of the receivables mentioned in the note (Bank's Exhibit B), the assignment also being dated April 8, 1964 and signed "Reed Plumbing, Heating and Air Conditioning, Inc., by Albert F. Reed, Jr.," without the designation "Pres."

The Bank's Exhibit B-2 (adopted by the trustee as Trustee's Exhibit 19) is the factor's lien agreement, also dated April 8, 1964, covering the bankrupt's supply and materials inventory and signed "Reed Plumbing, Heating and Air Conditioning, Inc., by Albert F. Reed, Jr., Pres."

The $16,000 note, the assignment of the receivables and the factor's lien agreement were all tied together in a single financing transaction occurring April 8, 1964, and in the circumstances it is difficult to understand how the Bank's Exhibit B is "outside the issues."

Referring again to Bank's Exhibit B: Albert F. Reed, the bankrupt's president, testified he signed said exhibit and that his wife Marcella Reed also signed it. Transcript, pp. 101-106.

Earlier, on cross examination of Mr. Reed, he testified that he could identify the Bank's Exhibit B and the signatures thereon, but before he was asked to do so, the trustee's counsel interposed the following objection (transcript, pp. 85-86):

> "There is no foundation to show that the document as executed is binding on the corporation, and, therefore, in any way binding upon the trustee and creditors, there being no proof in the record yet showing the authority to execute this instrument; that on its face the instrument contains no identification that it was signed in the corporate capacity and until such time as any proof is in the record to show that this exhibit is binding in any way upon the trustee I will object on the ground that this exhibit is completely immaterial to any of the issues in this case and no foundation laid."

In these circumstances the exhibit was received subject to the objection. Transcript, p. 87.

At pages 99-100 of the transcript the trustee's counsel reiterated his objection that there was no identification of the capacity in which Marcella Reed signed the note (Bank's Exhibit B) and on pages 100-101 of the transcript counsel for the trustee asserted that the law of this State is "that you cannot, by parole evidence, show the capacity in which an individual has signed, particularly where you have the trustee in bankruptcy. I would also like to point out that nowhere in the pleadings is there a request made to reform the instruments * * *," the objections being overruled.

Further, with reference to the parole evidence rule, identification of the representative capacity in which a party may have signed a written instrument does not contradict, vary or add to the terms of the instrument and is not within the rule. Vol. 7, Dunnell's Minn. Digest, 3rd Ed., Sec. 3371 and cases cited.

Moreover, certain exhibits introduced by the trustee show that Marcella Reed was in fact the secretary of the bankrupt corporation at all the times material in this dispute. See Trustee's Exhibit 2—"Corporate Records"—containing the corporate by-laws and board minutes and see Trustee's Exhibit 13 (also marked Respondent's Exhibit B-3) consisting of a certification to the bank of a board resolution designating Marcella Reed as the secretary of the bankrupt corporation. The fact of her secretaryship was not disputed throughout the making of the record covering this dispute. The dispute concerns the question whether she signed the Bank's Exhibit B in her capacity as secretary of the bankrupt corporation or in an individual capacity. In the latter respect, any such contention could not be sustained in the face of the record made in this case.

III.

In the setting afforded by foregoing Paragraph II hereof, the issues presented for review appear to be:

> Whether the referee erred in inferring that Marcella Reed signed the $16,000 note (Bank's Exhibit B) in her capacity as secretary of the bankrupt corporation and not as an individual.

Whether the referee in finding that the $16,000 note aforesaid constituted an obligation of the bankrupt corporation.

> Whether in finding that the $16,000 note aforesaid was a corporate obligation, there was a violation of the parole evidence rule.

IV.

Additional issues presented for review:

Whether (in Paragraph XVIII of his findings and conclusions) the referee erred in applying the first sentence of Sec. 70c of the Bankruptcy Act and in failing to apply the second sentence of the same section and accordingly holding, in effect that in the instant matter the trustee stands in the shoes of the bankrupt with respect to the prosecution of this proceeding against the bank, and

Whether the referee erred in affording equitable relief to the bank and in so doing ventured "outside the issues made by the pleadings."

With respect to the foregoing, Paragraph XVIII of the referee's findings and conclusions speaks for itself, except for the charge that in determining the respective rights of the trustee and the bank the referee ignored their respective pleadings.

Referring to Paragraph 1 of the trustee's petition, the trustee points to "repeated efforts to compromise and settle" the subject matter thereof with the bank; and in Paragraph 2, the trustee alleges therein that it is necessary that the court proceed with the orderly administration of this bankrupt

estate, including a decision of the lien claims of the bank against the assets in the bankrupt estate. In the prayer of his petition, the trustee requests a hearing "to determine the question of the validity" of the bank's claims against the bankrupt's estate. Then, in Paragraph 3b of the bank's answer, the bank points to the $16,000 loan made to the bankrupt and alleges "that all of the proceeds of said loan were in fact received by the bankrupt corporation." The referee's holding in XVIII is in line with this particular allegation by the bank. And the bank's prayer is, in effect, that the bankruptcy court determine the validity of its security interests.

On page 16 of the referee's findings and conclusions, the bankruptcy court's jurisdiction in equity is discussed.

Where a court is vested with equity jurisdiction it has the power "to do equity and to mould each decree to the necessity of the particular case." Hecht v. Bowles, 321 U.S. 321, 329. In Camp v. Boyd, 229 U.S. 530, it is said (p. 551) that a court of equity ought to do justice completely and not by halves and (at pages 551-552) it is said that the court may go beyond the matters immediately underlying its equitable jurisdiction and decide whatever other issues and give whatever other relief may be necessary under the circumstances and that only in that way can equity do complete rather than truncated justice.

However the foregoing may be, if in the particular circumstances of the case now at bar the rule is applicable that a court may not, without the consent of all persons affected, enter judgment which goes beyond the claim asserted in the pleadings, it probably should be remembered that a proceeding in bankruptcy from the time of its commencement until it is closed is but one suit; that proceedings in a bankruptcy suit at any time prior to its termination are open for re-examination upon application therefor in ap-

propriate form. Webster v. Barnes Banking Co., 10 Cir., 113 F.2d 1003, 1005 (followed by Aune v. Reynolds, 10 Cir., 344 F.2d 835).

Further, the issue in the instant case (whether within the pleadings the bank is entitled to the equitable treatment accorded it) appears to be one concerning which the required proof is in the record and the introduction of further evidence is not required, the question involved appearing as one entirely for the reviewing judge.

V.

Referring to Paragraph XIX of the referee's findings and conclusions, the issue appears to be

> Whether the referee erred in holding that the trustee had failed to establish, to the degree required by law, the statutory element of "greater percentage" specified in Sec. 60 of the Bankruptcy Act—11 U.S.C.A. 96—relating to preferential transfers.

In Paragraph XIX of his findings and conclusions (at page 18 thereof) the referee sets forth what he believes to be the generally accepted method of proving the element of greater percentage required (among other elements) to establish a preferential transfer.

The trustee offered and there was admitted in evidence the official claim register (Trustee's Exhibit 21) maintained by the referees' office in this pending bankruptcy proceeding. This exhibit, of course, is merely a piece of paper. The claims proved and filed "in time" against this bankrupt estate were not offered and consequently were not incorporated in the record.

As stated in Paragraph III of the referee's findings and conclusions, the date of bankruptcy herein is June 12, 1964. The claim filing period prescribed by Sec. 57n of the Bankruptcy Act—11 U.S.C.A. 93—had expired prior to the time the hearing was held in this dispute. Those creditors who

had not filed and proved their claims within the statutory period are deemed to have waived them.

Under the bankruptcy law, dividends are paid only on formal proofs of unsecured claims filed "in time." In the tabulation appended to the trustee's petition for review, the following appears:

"Unsecured claims . . . Exhibit 21 . . . $22,780.61." There is no proper proof in the record establishing this figure.

In the same tabulation appended to the trustee's petition for review, the aggregate amount of the accounts receivable of this estate is shown as $18,000. The amount the trustee actually realized on these accounts does not appear in the record. In the same tabulation it is made to appear that at page 46 of the transcript, the witness Albert F. Reed, Jr. testified with respect to certain assets. But his testimony does not disclose the amounts which the trustee realized on them. The tabulation sets forth that the merchandise inventory, office furniture and tools were sold by the trustee for $8,668.68. So far as the referee is able to ascertain, there was no proper evidence, documentary or otherwise, offered and admitted in the record to establish this figure. The only two other items of realization mentioned in the tabulation are the amounts for which several trucks were sold, to-wit: the sums of $35.00 and $250.00 mentioned in Paragraph X of the referee's findings and conclusions.

A referee in bankruptcy cannot make a finding (that is not to be deemed erroneous) unless the finding is supported by competent proof appearing in the record; and the only base for a finding that the bank, as the beneficiary of a preferential transfer, enjoyed a greater percentage of its debt than some other creditor of the same class would necessarily have to be arrived at by calculation predicated upon the amount creditors, who had filed proofs of unsecured claim "in

time," would receive by way of a dividend, compared with the benefits the transferee received by virtue of the transfer. The referee could find in the record no basis for any such calculation.

VI.

The final and last issue for determination on this review appears to be that the referee erred in failing to consider the additional issue litigated and submitted by the trustee at page 4 of his brief

> Whether the bank received, either fraudulently, or at least preferentially, a payment of $1,100.00 on or about May 7, 1964 (Trustee's Exhibit 9), such payment having been made by one Berghorst for a motor vehicle owned by the bankrupt corporation.

Nowhere in the trustee's petition herein is the bank charged with "fraud."

The trustee having failed to prove all of the elements of a preferential transfer, the proposition raised by the foregoing assignment is and was not deemed by the referee to be consequential.

At Minneapolis, Minn., July 27, 1967.

Respectfully submitted,

GEO. A. HEISEY
Referee in Bankruptcy

ORDER

(Filed September 28, 1967)

To James E. Culhane and M. L. Culhane and Culhane & Culhane, attorneys for trustee; Thomas G. Lovett, Jr., attorney for respondent First National Bank of Anoka:

The trustee for the bankrupt has filed a petition for review of the findings, conclusions and order of the referee in bankruptcy filed June 29, 1967.

The Court has considered the arguments and briefs of counsel.

On all the files and proceedings herein the Court is convinced that the findings and conclusions are not clearly erroneous.

It Is Ordered, therefore, that the findings, conclusions and order of the referee filed June 29, 1967, be, and they are, in all respects confirmed.

Dated September 27, 1967.

/s/ EARL R. LARSON
United States District Judge

MEMORANDUM

This bankruptcy controversy is before the Court on the petition of bankruptcy trustee Edward R. Kenneally to review the referee's findings, conclusions and order filed June 29, 1967.

The bankrupt, Reed Plumbing, Heating and Air Conditioning, Inc. (Reed, Inc.), was incorporated pursuant to Minnesota law November 21, 1963, to engage in the business of plumbing, heating and air conditioning. On April 8, 1964, Albert F. Reed, Jr., president and one of four directors of Reed, Inc., negotiated a $16,000 loan with the First Na-

tional Bank of Anoka (bank). The validity and effect of this transaction are dispositive of several of the findings at issue in this case.

The note on this loan was signed:

Reed Plumbing, Heating and Air Conditioning, Inc.
By Albert F. Reed, Jr., Pres.
Marcella E. Reed.

Marcella Reed, the wife of Albert Reed, is secretary and a director of Reed, Inc. The $16,000 loan incorporated $11,436.94 in antecedent debts and included $4,563.06 advance of new money. On the same date, the bank received as security on the note (1) an assignment of $21,015.45 in accounts receivable signed:

Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr.

and (2) a factor's lien on the inventory of Reed, Inc., signed:

Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr., Pres.

Between the date of the loan, April 8, 1964, and June 12, 1964, the date Reed, Inc., initiated this proceeding by filing a voluntary bankruptcy petition, the bank received $9,095.36 in repayment on the note.

The referee:

1. Found that the bankrupt, Reed, Inc., was estopped to deny the validity of the securities on the note, and thus the bank had an equitable lien against the proceeds from the trustee's sale in the amount of $6,904.64, which the bankrupt had not repaid on the $16,000 note.

2. Found that the petitioner trustee had not proved his contention that the bank was the beneficiary of a preferential transfer of the $9,095.36 repayment on the loan within Bankruptcy Act §60(a), 11 U.S.C. §96a (1964). The referee found that the trustee had not sustained the burden of prov-

ing the requisite "greater percentage" element, and he could not find in the record any basis for the statutory calculation that ". . . the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

3. Found that in light of the equitable lien and the denial of the preferential transfer claim, petitioner trustee's contention that the bank's claim, if granted, should be limited to the $4,563.06 new money advanced under the $16,000 loan was not material.

4. Denied petitioner's claim for a $1,100 set-off against any claim allowed the bank because the bank "received, either fraudulently, or at least preferentially, . . ." a payment of $1,100 from one Berghorst as purchase price on certain motor vehicles owned by the bankrupt and mortgaged to Albert F. Reed, Jr., personally. The referee found that the trustee had not charged fraud. Thus, in view of his failure to prove all the essential elements of a preferential transfer, the $1,100 set-off contention became inconsequential.

The referee entered an order allowing respondent bank's $6,904.64 claim against the proceeds of the Court ordered sale presently in the hands of the trustee. The trustee contends that the enumerated findings of the referee are erroneous and petitions this Court for a reversal of the referee's order allowing the bank's $6,904.64 claim. This Court affirms this part of the order of the referee.

Initially, the trustee objected to the formulation of the referee's certificate and return of petition for review. A formulation of findings and questions presented for review is proper under §39(a) of the Bankruptcy Act, 11 U.S.C.A. §67(a) (1958).

The referee found the April 8, 1964, note for $16,000 to be a valid corporate obligation. The trustee contends that the note is invalid because of the lack of the word "Secre-

tary" after the signature of Marcella Reed. The trustee maintains Marcella Reed signed the note as an individual. The referee found that ". . . the note constituted a valid corporation obligation inasmuch as in all the circumstances, the fact that Marcella Reed executed the note in her official capacity as secretary of the bankrupt corporation can reasonably be inferred." The Court agrees that the inference that Marcella Reed signed the note in her official capacity is a reasonable one. The Court has not been able to find any cases nullifying the legal validity of a corporate document where evidence points to its validity simply because the official designation of one of the two required official signatures has been omitted. Here the trustee has not produced any evidence that Marcella Reed signed the note as an individual. Here both parties understood the dealings to be with the corporation. The corporation received $11,436.94 to pay antecedent debts it owed the bank. The corporation had the benefit of the remaining $4,563.06. As it had in the past, the bank on the same day received security in the form of an assignment of accounts receivable of the corporation. Also, on the same day the bank received security in the form of a factor's lien on the inventory of the corporation. The bank relied on the certificate filed with it by the corporation requiring the signatures of the president and the secretary to borrow money. The bank knew Marcella Reed was the secretary of the corporation. The trustee does not challenge either Marcella Reed's official capacity or the bank's knowledge of it. The referee's findings are entitled to considerable weight. They should be overturned if they are clearly erroneous. Here there was no evidence that Marcella Reed signed the note as an individual. In these circumstances there is no reasonable explanation for such a personal signature. There are not persuasive parol evidence

objections. The Court affirms the referee's finding that the $16,000 note was a valid corporate obligation.

The referee found the securities for the loan, the assignment of accounts receivable and the factor's lien legally invalid corporate obligations. The referee found, however, that the trustee was equitably estopped to deny the validity of the securities under the Bankruptcy Act §70(c), 11 U.S.C.A. §110(c).

The question of the legal validity of the securities is a close one. The certificate filed with the bank by the bankrupt was perhaps ambiguous. Both official signatures were required to borrow money. But, after this requirement, the certificate stated "said officers are authorized" to pledge or secure money borrowed. This language can be interpreted to mean said officers jointly or that said officers separately have such authority. The fact that the security language differs from the borrowing language immediately preceding it tends toward an interpretation that the authority required is different. In circumstances such as these, especially where, as here, a corporate certificate has been filed, the Court finds no case holding a bank or lender responsible for knowing and following the corporate by-laws of its borrower. In the past, assignments had been made in this fashion. All requirements of the statutes covering the assignment of accounts receivable at the time of assignment were complied with M.S.A. §§ 521-521.07, specifically §521.02 (all since repealed and covered by the U.C.C.). No acknowledgment was needed. In re Dissolution of School District No. 33, 239 Minn. 439, 60 N.W.2d 60 (1953). No objection to the factor's lien was made on statutory grounds. M.S.A. §§ 514.80-514.91 (likewise applicable here but since repealed and replaced by the U.C.C.). The signature on the factor's lien clearly shows that Albert Reed signed the lien in his official capacity as president of Reed, Inc. As we said, supra, concerning the

validity of the corporate note, all the evidence here indicates that this was a corporate transaction. Trustee did not introduce evidence or testimony to the contrary. On the question of legal validity of the assignment and lien as corporate instruments, an express or implied authority argument can be made. In these circumstances ratification can easily be supported. And it appears that the bank may well have been justified in accepting Albert Reed's apparent authority to execute these securities.

Review of the question of the validity of the securities is urged on the Court by the bank. Such review is, of course, open to the Court. In re Michael's Cafeteria, Inc., 52 F. Supp. 799 (D. La. 1943). This Court believes and concludes that the securities were validly executed and thus were valid and legal collateral obligations of Reed, Inc.

At the same time the referee found the securities legally invalid, he achieved a similar result by finding the trustee equitably estopped to deny their validity. The referee was aware that this finding rendered the question of the legal validity of the instruments moot as far as the outcome of the case. The Bankruptcy Court functions as a court of equity. The Court finds equitable estoppel clearly established. Reed, Inc., received the benefit of the money. The securities were part of the transaction, necessary to the receipt of the money. The corporation is clearly estopped to deny the validity of the securities. The trustee cannot generally challenge the validity of the securities with a defense the bankrupt could not raise. Bankruptcy Act §70(c), 11 U.S.C.A. §110(c). Estoppel is imputed to the trustee under §70(c). 4 Collier, Bankruptcy §70.45 (14th ed. 1964). Neither a succession to a corporate claim against its officers for unauthorized acts theory nor a claimed creditor's lien under the second sentence of §70(c) aid the trustee's argument against equitable estoppel.

The referee found that the trustee did not prove that the $9,095.36 the bank received in payment on the $16,000 loan was a preferential payment within Bankruptcy Act §60(a), 11 U.S.C. §96(a) (1964). The Court agrees.

The referee found that the trustee introduced no evidence tending to establish the requisite greater percentage element of §96(a) which reads ". . . the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class." Since the trustee is equitably estopped to deny the validity of securities on the loan, the bank is deemed to be a secured creditor. Thus the trustee's claim that the bank was an unsecured creditor could not be established. The referee undoubtedly had this in mind in denying the trustee's claim. Aside from this, the trustee did introduce some evidence tending toward establishing the greater percentage.[1] The trustee introduced the bankruptcy claim register and schedule, the general ledger and journal of the bankrupt, the accounts receivable ledger and paid up accounts receivable of the bankrupt and the appraisal and inventory of bankrupt's assets. The trustee also introduced testimony of the president of the bankrupt and an appraiser. No objections to this evidence were made by the bank. If the bank were treated as an unsecured creditor, even though the proof of the trustee is not entirely adequate, it appears the greater percentage element—determined by the actual effect of payment when bankruptcy results[2]—might have been established. However, all elements must be proved by the trustee to establish a preferential pay-

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[1] *Riccio v. General Motors Acceptance Corporation*, 203 A.2d 92 (1963), says trustee has burden of introducing statement of assets and liabilities of bankrupt and goes on to point out other evidence which could be admitted. *Barry v. Crasner*, 192 F.2d 939 (8th Cir. 1952), is a case where no evidence was submitted by the trustee.

[2] *Palmer Clay v. Brown*, 297 U.S. 227 (1935).

ment. In this case the trustee failed to prove that the bank had reasonable cause to believe the bankrupt was insolvent at the time or times of repayment. The bank on April 8, 1964, made a new loan to bankrupt. Logically this is evidence that the bank felt Reed, Inc., was solvent, and there is solid precedent in the 8th Circuit that such a loan cuts strongly against knowledge of insolvency. Harrison v. Merchant's Nat. Bank, 124 F.2d 871 (1942). The same case points out the accepted view that mere suspicion or apprehension is not equivalent to good or reasonable cause to believe that insolvency exists. On the record there is an unresolved dispute whether an audit showing bankrupt's net worth as of March 31, 1964, to be over $21,000 was in the hands of the bank at the time of the loan, but the stronger inference is that it was. At least, the audit had been made and the bank knew about it during the course of repayment before Reed, Inc., initiated the bankruptcy proceedings on June 12, 1964. Thus, even if the equitable lien did not preclude a preferential payment finding under Bankruptcy Act §60(a), it appears that the trustee did not prove the requisite knowledge of insolvency and therefore did not establish the preferential transfer.

In view of the trustee's failure to prove a preferential transfer, the referee is correct in finding that the trustee's claim that a distinction can be made between the $4,563.06 in new money advanced under the $16,000 loan and the $11,436.94 covering old debt is not material. Further, it is clear that even under Bankruptcy Act §60(a) no such distinction could be drawn. See Engelkes v. Farmers Cooperative Company, 194 F. Supp. 319 (N.D. Iowa 1961).

The trustee's claim for a $1,100 set-off against any claim allowed respondent bank is properly before the Court. The trustee has not shown any fraud and the trustee has failed to prove any preferential payment. The president of Reed,

Inc., took steps insuring the receipt of such money by the bank. There was no coercion by the bank. In the circumstances, the bankrupt received the benefit of the money. The $1,100 set-off claim of the trustee is denied.

Other contentions of the trustee are without merit.

The Court must therefore sustain the findings of fact, conclusions of law and order of the referee.

EARL R. LARSON

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

No. 19,108

Edward R. Kenneally, Trustee of Reed Plumbing, Heating and Air Conditioning, Inc.,

Appellant,

vs.

First National Bank of Anoka,

Appellee.

Appeal from the United States District Court
For the District of Minnesota

[September 24, 1968.]

Before MATTHES and HEANEY, Circuit Judges, and REGISTER, Chief District Judge.

HEANEY, Circuit Judge.

The trustee in bankruptcy appeals from an order of the District Court confirming the referee's decision. The referee found that the trustee was estopped to deny that the bank was a secured creditor by virtue of an assignment of accounts receivable and a factor's lien. We hold that the security instruments were not valid, did not bind the corporation or estop the trustee and that payments received by the bank under these instruments were preferential under §60 of the Bankruptcy Act (11 U.S.C. §96). We reverse and remand with directions to determine the validity of prior assignments of accounts receivable.

Reed, Inc., was incorporated pursuant to Minnesota law on November 21, 1963. Albert F. Reed, Jr., a thirty per cent stockholder, was named President. His wife, Marcella Reed, a ten per cent stockholder, was named Secretary. The other stockholders were Rosina Popp, Vice President, a fifty per cent stockholder, and Marie Reed, Treasurer, a ten per cent stockholder.

On February 24, 1964, Mr. Reed negotiated a $12,000 loan with the First National Bank of Anoka. The loan was evidenced by a note whose terms are not apparent from the record. Accounts receivable, having a book value of $12,164, were assigned as security. The assignment was executed by Reed. His wife did not join in its execution. Additional assignments, with or without Mrs. Reed's signature, may have been made as payments were made on those originally assigned.[1]

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[1]The books of the bankrupt, received as an exhibit, indicate that payments were made to and additional loans were received from the bank between February 26 and April 8, 1964. Neither the books nor other testimony indicate whether additional accounts receivable were assigned or substituted. Absent a record of other assignments, we consider the validity of the one of April 8th only.

In late March or early April, Reed, Inc., was in need of funds to meet payrolls and other operating expense. On April 8th, Mr. Reed negotiated a new loan with the bank. On that date, $11,436 remained to be paid on the February 24th note. The face value of the uncollected accounts receivable was $8,700. Their actual value was substantially less than that amount.[2] The bank advanced an additional $4,564, cancelled the original note and took a two-week eight per cent note for $16,000 from the corporation. The bank also took an assignment of accounts receivable and a factor's lien on the inventory as security. The accounts receivable assigned, which apparently included those previously assigned, had a book value of $21,000 and a subsequently appraised value of $15,750.

The inventory (merchandise) had a book value of $21,000 and a subsequent determined appraised value of $7,931.[3]

The April 8th note was signed:

"Reed Plumbing, Heating and Air Conditicning, Inc.
By Albert F. Reed, Jr., Pres.
Marcella E. Reed."

The April 8th assignment was signed:[4]

"Reed Plumbing, Heating and Air Conditioning, Inc.
By: Albert F. Reed, Jr."

And the April 8th factor's lien was signed:

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[2]The court appointed appraiser testified that the fair value of the accounts receivable was at least twenty-five per cent less than their book value, and that the $100 carried as a reserve for bad debts was insufficient.

[3]The appraiser testified that he inventoried the merchandise at $17,624, and appraised it at $7,931; he inventoried office furniture at $84 and appraised it at $52; and he inventoried miscellaneous hand tools at $85 and appraised them at $34. The trustee sold the above items for $8,668. Trucks were inventoried at $2,275, appraised at $300, and sold for $285.

[4]The February 24, 1964, assignment was executed in the same manner.

"Reed Plumbing, Heating and Air Conditioning, Inc.
Albert F. Reed, Jr., Pres."

The sum of $9,095 had been paid on the April 8th note by June 12, 1964. On that date, Reed, Inc., initiated this proceeding by filing a voluntary bankruptcy petition.

THE VALIDITY OF THE NOTE, THE ASSIGNMENT AND THE FACTOR'S LIEN OF APRIL 8TH.

The Note.

The corporate resolution authorizing Reed, Inc., to borrow money and give security for it required the signatures of the President and the Secretary. This resolution was filed with the bank on a form provided and completed by the bank.

The trustee contends that the absence of the word "Secretary" in Mrs. Reed's signature defeats its validity. He also argues that Mrs. Reed signed the note in her individual capacity.

The referee found that the word "Secretary" had been inadvertently omitted from the note. He also found that it could be inferred from the circumstances that Mrs. Reed had signed the note in her official capacity. These findings are supported by substantial evidence.

The inadvertent omission of the signer's title will not affect the validity of an instrument where it is clear the instrument was signed by a party in an official capacity. *Towers v. Stevens Cattle Co.*, 83 Minn. 243, 86 N.W. 88 (1901); *Bentall v. Koenig Brothers, Inc.*, 140 Mont. 339, 372 P.2d 91 (1962); *St. Clair v. Rutledge*, 115 Wis. 583, 92 N.W. 234 (1902); 7 Fletcher on Corporations §3035, p. 103. We affirm the decision of the referee and the District Court holding the note valid.

The Factor's Lien and Assignment of Accounts Receivable of April 8th.

The referee found: that while the factor's lien and the assignment both bore the date of April 8, they had been signed after the note and at a time when Mrs. Reed was not present; that neither Mrs. Reed nor the other officers of Reed, Inc., had either prior or subsequent knowledge of their existence; that the bank was aware of the requirement that the signatures of the President and the Secretary were required on any security instruments; that the bank knew that the President's signature was the only one on the security instruments; and that there was no evidence to support the view that the directors and the stockholders, other than Reed, had acquiesced in signing the security instruments or to support the view that authority for him to sign could be implied from past transactions.

The referee concluded that the President had neither express nor implied authority to bind the corporation by his signature alone, that he was without apparent authority to do so and that his act had not been ratified by the corporation.

The District Court, on the other hand, held that the factor's lien and the assignment were validly executed corporate instruments because: the bank was not responsible for knowing and following the corporate by-laws; the President had been the sole executor of an earlier assignment; the President had signed the April 8th instruments in his official capacity; the transaction was a corporate one; an argument for express or implied authority could be made; and ratification could be supported.

We agree with the referee's conclusion that the security instruments were invalid.

Reed was without express or implied authority to bind the corporation by his signature. Express authority was

negated by the terms of the resolution. While implied authority may be inferred from facts and circumstances, *Best v. Krey,* 83 Minn. 32, 85 N.W. 822 (1901); Restatement, Second, Agency §7 Comment c., where a principal has expressly required the concurrence of two officers to exercise a specific authority, neither has implied authority to exercise such power without concurrence of the other. *Bloomingdale v. Cushman,* 134 Minn. 445, 159 N.W. 1078, 1080 (1916).

The appellee argues that Reed's authority to sign the factor's lien and the assignment can be implied from the fact that his wife joined in the execution of the note. We do not agree. The authority to give security instruments cannot be inferred from the authority to borrow. *The American Nat. Bank v. Bartlett,* 40 F.2d 21 (10th Cir. 1930); Restatement, Second, Agency §75 Comment b. See, *Wells & Co. v. Sharp,* 208 F. 393, 398 (8th Cir. 1931).

The appellee also urges that a finding of apparent authority can be sustained as (1) the resolution furnished to the bank was ambiguous, and (2) there was a history of the President alone executing security instruments on behalf of the corporation.

In our view, the resolution is unambiguous. It provides:

> "RESOLVED, that *Albert F. Reed, Jr., President, and Marcella E. Reed, Secretary (both signatures required),* be and they hereby are authorized to borrow from time to time on behalf of this corporation from the above bank sums of money * * *.
>
> "That said officers are hereby authorized to pledge or mortgage any of the [property] * * * of the corporation, * * *."

(The italicized words were typed by the bank.)

The appellee's second contention is also without merit as only those who have acted in reliance upon the apparent authority of the agent are entitled to recover where the agent possessed no actual authority, express or implied. *Dispatch*

Printing Co. v. National Bank of Commerce, 115 Minn. 157, 132 N.W. 2 (1911); Restatement, Second, Agency §8 Comment c. Here, there was no reliance as the bank knew that two signatures were required and only one was present.

The District Court found that "ratification can be easily supported." We do not agree. There is no evidence that any of the officers, other than the President, had knowledge of the execution of the security instruments. While knowledge of an officer may be imputed to a corporation, the knowledge must be that of an officer; other than the wrongdoer, if the corporation is to be bound. *Ft. Dearborn Nat. Bank v. Seymour*, 75 Minn. 100, 77 N.W. 543 (1898); Restatement, Second, Agency §§ 91, 272 Comment c.; 2 Fletcher on Corporations §§758-59, pp. 1087-89.

Nor were the security instruments ratified by a retention of benefits. The corporation received and retained $4,500 in additional funds as a result of the loan. While Mrs. Reed signed the note and presumably knew that the corporation was obtaining $4,500 in additional funds, there is no evidence indicating that she or the other officers knew that the factor's lien and the assignment of accounts receivable had been given to secure the note. Such knowledge cannot be imputed to her or the corporation.[5] *The American National Bank v. Bartlett, supra*;[6] Restatement, Second, Agency §91; 2 Fletcher on Corporations §758, pp. 1087-88.

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[5]The referee surmised "• • • that Marcella Reed may have refused to sign the factor's lien agreement because of its crippling effect on the business operation of the bankrupt corporation. • • •"

[6]In *Bartlett*, the general manager of the corporation executed, without authority, a mortgage to secure a note which the bank would not renew without security. The general manager who was also the Secretary of the corporation, had the authority "'to do whatever was necessary to keep the business going'" and he had in the past borrowed from the bank. The other officers and directors knew of the loan but not the security arrangement and the corporation made payments on the note. It was held:

The referee, while rejecting the validity of the security instruments, found that the bankrupt was estopped to deny their validity on equitable principles and that the trustee was similarly estopped. He stated:

> "It is settled that in a case where the facts and circumstances happen to be as they are here, the bankruptcy court functions essentially as a court of equity and that equitable processes govern the exercise of that court's jurisdiction. In the opinion in *Redmond v. United Funds Management Corp.*, 8 Cir., 144 F.2d 155, reference is made to 'a court of conscience' which assures justice to all parties since 'the malleable processes of courts of bankruptcy give assurance of a remedy that can be moulded and adapted to the needs of the occasion.' * * *."

The District Court agreed that the trustee was equitably estopped to contest the validity of the security instruments.

We do not believe that the doctrine of equitable estoppel can be applied under the circumstances of this case. Two elements are missing:

(1) "* * * There can be no estoppel as to facts equally known to both parties or as to facts which the party invoking the estoppel ought, in the exercise of reasonable prudence, to know. * * *."

Froslee v. Sonju, 209 Minn. 522, 297 N.W. 1, 4 (1941); 6 Dunnell Digest (3d Ed.) §3189. Here, the bank knew that Reed alone could not execute a valid security instrument:

(2) "There can be no estoppel unless the party sought to be estopped had full knowledge of the facts at the

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"* * * [I]t is apparent that no question of ratification in fact, or of ratification by voluntary retention of the benefits of an agent's unauthorized act, is present; and this for the reason that neither the corporation or Mr. Mayer [President of the corporation whose authority was needed to validly execute the mortgage] had any knowledge of the execution of the mortgage prior to the bankruptcy. Full knowledge of the unauthorized act, and of all material matters related to it, is an essential to a valid ratification. * * *."

The American Nat. Bank v. Bartlett, 40 F.2d 21, 23 (10th Cir. 1930).

> time of the representation, concealment, or other conduct claimed to give rise to an estoppel, or was guilty of culpable negligence in not knowing them. * * *."

Froslee v. Sonju, supra, at 4. Here, there is no showing that any of the officers of Reed, Inc., other than Albert Reed, knew or were guilty of negligence in not knowing that the President had executed the assignment and the factor's lien.

We conclude that the security instruments of April 8, 1964, are invalid and that neither Reed, Inc., nor the trustee is estopped to deny the validity.

We turn to the questions of (1) whether the February 24th assignment was valid, and, if so, (2) whether the bank is entitled to be treated as a secured creditor to the extent of the value of the accounts receivable assigned on that date and remaining uncollected on the date of bankruptcy.

The trustee challenged the validity of this assignment but little evidence was offered on the issue. The referee and the District Court used language in their opinions supporting its validity but did so largely on the basis of their decision holding the trustee estopped to assert the invalidity of the April assignment.

Were we to base our decision on the evidence offered, we would be required to hold that the February assignment was invalid. We are reluctant to decide the issue, however, as there may be facts or circumstances substantiating its validity which have not been presented.

We believe that the failure to offer all the evidence relating to its validity is understandable in the light of the theory under which the case was tried and that the parties should be given the opportunity on remand to offer additional evidence bearing on this issue. This will permit substantial justice to be done. See, 28 U.S.C. §2106 (1964 ed.); *Pepper v. Litton,* 308 U.S. 295, 304-05 (1939); *United States v. Duggan,* 210 F.2d 926 (8th Cir. 1954); *United States v. Hall,* No. 18951 (8th Cir. July 12, 1968).

If the February assignment is found to be valid, the bank is entitled to be treated as a secured creditor to the extent of the value of the assigned but uncollected accounts receivable.

Support for this position is found in decisions holding that the substitution of one security for another of greater value constitutes a voidable preference but only to the extent that the substituted security exceeds the value of the original one. *In Re Grosse*, 24 F.2d 305 (7th Cir. 1928); *In Re Pusey, Maynes, Breish Co.*, 37 F. Supp. 316 (D.C. Pa.), *aff'd* 122 F.2d 606 (3d Cir. 1941); 3 Collier on Bankruptcy (14th Ed.) §6021, pp. 862-64.

We believe that, absent fraud, the rationale of these decisions can be extended to support the proposition that the substitution of an invalid security for a valid one does not operate to deprive a creditor of the benefits of the valid security. There is no evidence of fraud here.

On remand, a determination should be made as to whether the earlier assignment was valid; and if valid, its value.

Were Payments Under the Note of April 8th Preferential?

There remains the question of whether payments of $9,095 received by the bank from Reed, Inc., on the valid $16,000 note between April 8 and June 12, 1964, constitute a preferential transfer.

The trustee, to prevail, must prove the seven elements which make up a voidable preference. Bankruptcy Act §60 (a) and (b), 11 U.S.C. §96 (a) and (b).[7] Of these elements,

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[7]The elements of a preference are: (1) the transfer of any of the debtor's property; (2) to or for the benefit of a creditor; (3) for or on account of an antecedent debt; (4) while insolvent; (5) within four months of filing of petition in bankruptcy; (6) which will enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class; and (7) such creditor has reasonable cause to believe that the debtor is insolvent at the time of transfer.

we are concerned with two: (1) did the bank have reasonable cause to believe the debtor insolvent at the time of the transfer; and (2) did the transfer enable the bank to obtain payment of a greater percentage of its debt than some other creditor of the same class?

The referee found that the trustee had established the first element but not the second. The District Court found the trustee had established the second but not the first. Both agreed—no preference.

The trustee has the burden of establishing insolvency at the time of transfer. *In Re Collins & Kiser Construction Company,* 204 F. Supp. 42 (D.C. Iowa), *aff'd sub nom Employers Mutual Casualty Company v. Hinshaw,* 309 F.2d 806 (8th Cir. 1962). However, he need not show actual knowledge.

> "* * * It is sufficient that a state of facts has been brought to the creditor's attention concerning the affairs and financial condition of the debtor that would lead a prudent businessman to conclude that the debtor is insolvent. The creditor is charged with the knowledge which a reasonably diligent inquiry would disclose. * * *."

C. A. Swanson & Sons Poultry Company v. Wylie, 237 F.2d 16, 19 (9th Cir. 1956).

It is conceded that the bankrupt was insolvent as of April 8, 1964.

We are not convinced that the referee's finding that the bank had reasonable cause to believe that the corporation was insolvent is clearly erroneous.[8] The bank demanded and received as security for the loan an assignment of all accounts receivable and a factor's lien on the inventory. This,

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[8]The clearly erroneous standard is applied to the referee's findings rather than to those of the District Court. *Employers Mutual Casualty Company v. Hinshaw,* 309 F.2d 806 (8th Cir. 1962); *Gross v. Fidelity & Deposit Company of Maryland,* 302 F.2d 338 (8th Cir. 1962); *O'Rielly v. Endicott-Johnson Corp.,* 297 F.2d 1 (8th Cir. 1961).

in and of itself, is an indication of insolvency. *C. A. Swanson & Sons Poultry Company v. Wylie, supra,* at 18, n. 7; *Marin v. A. Y. McDonald Mfg. Co.,* 159 Minn. 447, 199 N.W. 176 (1924). The conversations between Mr. Reed and the bank when the loan was made are indicative of insolvency. Reed stated that he needed the money immediately to meet his payroll and to continue in business. The bank acknowledged that it told Reed that if he didn't get additional money immediately that he was going to fold. The terms of the loan, eight per cent interest with maturity in two weeks, suggest a corporation in difficulty.

We also hold that the trustee introduced sufficient evidence to establish the greater percentage element. The bank has received a payment of $9,095 on the $16,000 note. The introduction of the general ledger and general journal, schedules in bankruptcy, claims register of the bankruptcy court pertaining to this bankruptcy, accounts receivable ledger and appraisal and inventory of assets when considered with the testimony of Albert Reed and John Sprague, the appraiser, leads inescapably to such conclusion.

The bankrupt's assets on June 12, 1964, were $22,250 against liabilities of $35,522.

ASSETS:	
Cash	$ 273
Accounts Receivable	13,624
Merchandise, office furniture, misc. hand tools (sold by trustee)	8,668
Trucks (sold by trustee)	285
	$22,250
LIABILITIES:	
Claim No. 17 (bank's claim allowed by referee as secured claim)	$ 6,904
Secured and Priority Claims	5,838
Unsecured Creditor Claims	22,780
	$35,522

The amount available for distribution on unsecured claims can be determined with reasonable certainty and the amount of dividends which could be paid on unsecured claims can be readily calculated. The benefit conferred on unsecured creditors can then be compared with the benefit conferred upon the beneficiary of the preferential transfer. Thus, it may be determined who would receive the greater benefit percentage-wise—the unsecured claimants or the beneficiary of the preferential transfer.

Subtracting the secured and priority claims ($5,840) from the assets ($22,250), we are left with $16,410 against unsecured claims of $29,684, which includes the bank's claim of $6,904. Each unsecured creditor will receive approximately fifty-five per cent of his claim, or approximately fifty-five cents on the dollar. When we consider the bank has already received payments of $9,095, it is obvious that the bank will receive a greater percentage of its claim than any other unsecured creditor of its class. The bank would have received $9,095, plus fifty-five per cent of the $6,904 claim.

One further issue remains for decision. On March 13, 1964, the bank made a personal loan to Mr. Reed in the sum of $4,300.[9] The bank took as security a chattel mortgage on

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[9]The testimony of Mr. Gregerson, President of the bank, clearly establishes this.

"Q. Was the loan made to the corporation?
A. No.
Q. To whom was the loan made?
A. To Albert F. Reed, Jr.
Q. Were you as the officer in charge of the loan directed to do anything particularly with the proceeds of the loan?
A. Yes.
Q. What were you directed to do?
A. To credit it, the proceeds of the loan, to Reed Plumbing, Heating and Air Conditioning Company [Directed by Reed.].
Q. Its account with the bank?
A. That is correct."

five trucks, which it assumed were personally owned by Reed. The trucks were, in fact, owned by Reed, Inc. The note and the mortgage were signed "Albert F. Reed, Jr." The proceeds of the loan were deposited by Mr. Reed in the bank to cover a corporate overdraft of approximately $4,000. On May 7, 1964, the corporation sold two of the trucks. The purchaser paid the agreed price, $1,100, to the bank. This was done on Reed's instructions.

The referee held that the note and mortgage were invalid corporate instruments as they had not been signed by the Secretary as required by the by-laws and the resolution on file with the bank. He stated:

> "The bank must look to Albert F. Reed, Jr., personally and to his individual estate for repayments of the monies lent him. Consequently, the bank is not entitled to hold the estate of the bankrupt corporation liable for such monies and is not entitled to a lien on the property and the estate of the bankrupt corporation to secure repayment."

The District Court confirmed this decision without comment. We sustain the decision for the reasons stated by the referee.

The referee refused to order a repayment of the $1,100, however, concluding that the payment did not constitute an illegal preference because the trustee had failed to prove the requisite greater percentage element. The District Court reached the same conclusion but gave a different reason for so doing. It held that the trustee had failed to prove that the bank had reasonable cause to believe that Reed, Inc., was insolvent at the time of the transfer and, thus, failed to prove a preferential transfer.

The respective reasons given by the District Court and referee are identical to those given by them in concluding that payments made on the April 8th assignment were not

preferential. We reject that reasoning on the grounds previously stated.

Reversed and remanded for action consistent with this opinion.

A true copy.

Attest:

Clerk, U. S. Court of Appeals, Eighth Circuit.

UNITED STATES COURT OF APPEALS
For the Eighth Circuit

September Term, 1968

No. 19,108

Edward R. Kenneally, Trustee of Reed Plumbing, Heating and Air Conditioning, Inc.,

Appellant,

vs.

First National Bank of Anoka,

Appellee.

Appeal from the United States District Court
For the District of Minnesota

Petition of appellee for rehearing filed in this cause having been considered, it is now here ordered by this Court that the same be, and it is hereby, denied.

It is further ordered:

THE PARAGRAPH BEGINNING AT BOTTOM OF PAGE 4 OF THE SLIP OPINION AND CONTINUING ON PAGE 5 IS AMENDED TO READ AS FOLLOWS:

> The referee found: that the factor's lien and assignment which were both dated April 8, 1964, were signed by Mr. Reed at a time when Mrs. Reed was not present; that neither Mrs. Reed nor the other officers of Reed, Inc., had either prior or subsequent knowledge of their existence; that the bank was aware of the requirement that the signatures of the President and the Secretary were required on any security instruments; that the bank knew that the President's signature was the only one on the security instruments; and that there was no evidence to support the view that the directors and the stockholders, other than Albert Reed, had acquiesced in signing the security instruments or to support the view that authority for him to sign could be implied from past transactions.

A NEW PARAGRAPH IMMEDIATELY AFTER THE AMENDED ONE WILL BE ADDED AND WILL READ AS FOLLOWS:

> Implicit in the above findings which are supported by the record is the unstated finding that the security instruments were signed by Albert Reed after Mrs. Reed had signed the note.

October 31, 1968